

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF WESTERN)	
LEWIS-RECTORVILLE WATER AND GAS)	
DISTRICT FOR A RATE ADJUSTMENT)	CASE NO. 92-313
PURSUANT TO THE ALTERNATIVE)	
RATE FILING PROCEDURE FOR SMALL)	
UTILITIES)	

O R D E R

On September 4, 1992, Western Lewis-Rectorville Water and Gas District ("Western Lewis") filed its application for Commission approval of a proposed increase in its rates for water service. Commission Staff, having performed a limited financial review of Western Lewis's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding Western Lewis's proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this Order.

IT IS THEREFORE ORDERED that all parties shall have 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, then this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky this 2nd day of April, 1993.

PUBLIC SERVICE COMMISSION


For the Commission

ATTEST:


Executive Director

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

APR 02 1993

PUBLIC SERVICE
COMMISSION

In the Matter of:

THE APPLICATION OF WESTERN)	
LEWIS-RECTORVILLE WATER AND GAS)	
DISTRICT FOR A RATE ADJUSTMENT)	CASE NO.
PURSUANT TO THE ALTERNATIVE)	92-313
RATE FILING PROCEDURE FOR SMALL)	
UTILITIES)	

STAFF REPORT

Prepared By: Mark C. Frost
Public Utility Financial
Analyst, Chief
Water and Sewer Revenue
Requirements Branch
Financial Analysis Division

Prepared By: Brent Kirtley
Public Utility Rate
Analyst Communications, Water
and Sewer Rate Design Branch
Rates & Research Division

STAFF REPORT

ON

WESTERN LEWIS-RECTORVILLE WATER AND GAS DISTRICT

CASE NO. 92-313

A. Preface

On July 17, 1992, Western Lewis-Rectorville Water and Gas District's Water Division ("Water Division") submitted its application seeking to increase its rates pursuant to the Alternative Rate Filing Procedure for Small Utilities ("ARF"). However, the application was not considered filed until September 4, 1992. The Water Division's proposed rates would produce an increase in its annual revenues of \$80,875, an increase of 56.3 percent over test-period normalized residential revenues of \$143,541.

On September 11, 1992, Western Lewis-Rectorville Water and Gas District's Gas Division ("Gas Division") submitted a ARF application wherein it is seeking to increase its rates.¹ In order to evaluate the requested increase in this present case and Case No. 92-331, the Commission Staff ("Staff") chose to perform a limited financial review of Western Lewis-Rectorville Water and Gas District's ("Western Lewis") total operations for the test-period, the calendar year ending December 31, 1991. Mark C. Frost and Tammy Page of the Commission's Division of Financial Analysis performed the limited review on October 21, 22, and 30, 1992. This report presents the Staff's recommendations relative to the Water

¹ Case No. 92-331, The Application of Western Lewis Water and Gas District for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities.

Division only, although Gas Division operations are discussed to the extent that certain expenses must be allocated between the two Divisions.

Mr. Frost is responsible for the preparation of this Staff Report except for Section B, Operating Revenues; Section D, Rate Design, and Appendix A, which were prepared by Brent Kirtley of the Commission's Rates and Research Division. Based on the findings contained in this report, Staff recommends that Western Lewis be allowed to increase its annual revenues from water rates by \$48,601.

Scope

The scope of the review was limited to obtaining information as to whether the test-period operating revenues and expenses were representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

B. Analysis of Operating Revenues and Expenses

Operating Revenues

The Water Division reported test-year revenue of \$143,141. Its application indicates that, at the date of filing, there were 976 customers. However, a review of the district's records by Beverly Davis of the Commission's Financial Audit Branch revealed that the district was providing water free of charge for the volunteer fire departments in both Tollesboro and Orangeburg. Per phone conversation with district office manager Jean Wright, 1991 fire department usage for Tollesboro was 49,950 gallons while usage

for Orangeburg was 6,150 gallons. Revenue that could have been gained from this usage has been included in the rate-setting computations. Results of the billing analysis performed by Staff indicate that operations should generate \$143,541 in annual revenue at current rates. For the purposes of this report, normalized test-year revenue shall be considered to be \$143,541, a difference of \$400 over reported test-year revenue collected.

Operating Expenses

The Water Division reported actual and pro forma test-period operating expenses of \$146,915 and \$168,364, respectively. The following are Staff's recommended adjustments to the Water Division's actual test-period operations:

Salaries & Wages: The Water Division reported test-period salaries & wages expense of \$44,257, which is comprised of maintenance and office salaries of \$23,781 and \$20,476, respectively. Western Lewis allocated 72 percent of the maintenance salaries and 50 percent of the office salaries to its Water Division.

The Water Division proposed to increase test-period salaries and wages expense by \$1,325 to a pro forma level of \$45,582. Western Lewis is concerned about employee turn-over. In order to retain its current work force, Western Lewis proposed to grant a 3 percent wage increase in 1992, which is the basis for the adjustment in the Water Division's allocated salaries.

During the test-period Western Lewis employed an office manager, office clerk, maintenance supervisor, and one full-time and various part-time maintenance employees. In the first quarter of 1991, Western Lewis replaced its manager and several employees and in 1992 Western Lewis eliminated its part-time positions.

Western Lewis did not give its employees a pay raise in 1991, but did grant a \$1 per hour wage increase in 1992, which results in approximate increases in the range of 6 to 10 percent per year. While the percentage increase in salaries may appear high, when the salaries are compared to those paid by comparable utilities, Staff is of the opinion that they are reasonable.

As previously mentioned, Western Lewis experienced an employee turn-over in the first quarter of the test period. Its current staff has gained experience and training that enables it to perform competently the required tasks. In order to maintain a continuity of service to its customers, it is important for Western Lewis to retain its current work force.

In evaluating pro forma adjustments, Staff utilizes the rate-making criteria of "known and measurable". An adjustment to salaries and wages based on the 1992 wage increase would meet that criteria. After analyzing and weighing all of the factors, Staff is of the opinion that the wage increases granted in 1992 are justified and reasonable.

Subsequent to the filing of the application, Western Lewis proposed to change its payroll allocation between the two

divisions. Beginning in 1992 the Water Division will be allocated 80 percent of maintenance salaries and 63 percent of office salaries. The maintenance salary allocation is based on a time study Western Lewis performed using the 1991 and 1992 daily time sheets. The office salary allocation was not based on a time study but rather on inquiry and observation of Western Lewis' office employees.

Staff is of the opinion that the proposed maintenance salary allocation is adequately documented, is reasonable and should be reflected in the Water Division's test-period operations. Staff is further of the opinion that Western Lewis failed to document adequately its proposed office salary allocation and therefore, the Water Division will still be allocated 50 percent of the office salaries.

Staff has calculated salaries and wages expense of \$50,876, as shown in Appendix B. Accordingly, salaries and wages expense has been increased by \$6,619.

Utility Expense: The Water Division proposed a pro forma level of utility expense of \$13,393, an increase of \$390 above its test-period level. In its application, the Water Division did not justify its proposed adjustment.

The Water Division was informed that a pro forma adjustment must be documented (e.g., invoice or contract) in order to meet the rate-making criteria of "known and measurable". As the Water Division did not provide documentation, its adjustment fails to

meet these criteria. Therefore, Staff recommends that this pro forma adjustment be denied.

In the test-period Western Lewis allocated 69 percent of its utility expense to the Water Division. However, the electricity purchased from Kentucky-Utilities ("KU") is used in the pumping and treatment of water and therefore, in 1992 those costs will be totally allocated to the Water Division. The office utilities are a shared expense that will be divided evenly between the two divisions.

Staff has determined that the Water Division's test-period utility expense is \$16,871² and therefore, recommends the utility expense be increased by \$3,868.

Materials & Supplies: The Water Division proposed a pro forma level of materials and supplies expense of \$40,459, an increase of \$14,500 above its test-period level. The Water Division attributed the increase in materials and supplies to the age of the system. To support the adjustment, the Water Division listed specific repairs and maintenance that are required.

As previously mentioned, the Water Division was informed that a pro forma adjustment must be documented (e.g., invoice or contract) in order to meet the rate-making criteria of "known and measurable". Staff requested the Water Division to provide an analysis of the required repairs that included the projected date

² KU Electricity - Filed
Office Utilities
Pro Forma Utility Expense

\$ 16,020
+ 851
\$ 16,871

of the repair, bids or invoices to document the repair costs, how the repair will be financed, and if the repairs will be capitalized.

The Water Division provided Staff with cost estimates or bids for a few of the repairs but did not provide dates the repairs will be made or how they will be financed. Given the uncertainty of when the Water Division will make the repairs or how they will be financed, Staff is of the opinion that the proposed adjustment fails to fully meet the rate-making criteria of "known and measurable". Accordingly, Staff recommends that this pro forma adjustment be denied.

Upon review of the 1991 revised trial balance, Staff noted that \$21,852 of maintenance was recorded in this account. In the test period, Western Lewis allocated 69 percent of its maintenance expense to the Water Division. However, in 1992 Western Lewis analyzed each invoice to identify the portion of charges applicable to each division, with only shared costs being allocated. Based on this analysis, Western Lewis determined that \$21,545³ of maintenance expenses were directly attributable to the Water Division. Staff has accepted this analysis and therefore recommends that materials and supplies expense be reduced by \$307.

³	Materials and Supplies	\$ 8,379
	Maintenance Mains and Services	3,743
	Maintenance Meters	3,183
	Maintenance Other Plant	+ 6,240
	Total Maintenance	<u>\$ 21,545</u>

Upon review of the above analysis and general ledger, Staff noted that truck reimbursements of \$3,770⁴ were misclassified as materials and supplies. Ordinarily, the incorrect classification of these reimbursements would not affect the overall determination of the Water Division's revenue requirement. However, in this instance, truck reimbursements should be excluded from this expense and therefore, materials and supplies expense has been reduced by an additional \$3,770. A discussion of truck reimbursements has been included in the section entitled Transportation.

In the test period, Western Lewis mistakenly allocated 50 percent of its 1991 Kentucky Rural Water Association dues in the amount of \$176 to the Gas Division. To rectify this error, Staff recommends that materials and supplies expense be increased by \$88.

Other Operating Expenses: The Water Division proposed a pro forma level of other operating expenses of \$23,022, an increase of \$4,820 above its test-period level. In its explanations of pro forma adjustments, the Water Division stated that this adjustment is, "a general increase of 25 percent for insurance, chemicals, office supplies, and professional services."

By way of documentation, the Water Division provided an analysis showing each expense account included in other operating expenses and revised its pro forma adjustment to reflect 9 months of actual 1992 data and 3 months of projections.

4	Maintenance Other Plant			\$ 3,520
	Account #6500 - Operating Exp.	\$ 500 x 50%	=	+ 250
	Truck Reimbursement			<u>\$ 3,770</u>

Staff is of the opinion that the proposed general increase of 25 percent and revised adjustments, which includes 3 months of projections, fail to meet the rate-making criteria of "known and measurable". Therefore, Staff recommends that this pro forma adjustment be denied.

Commissioner Fees: The Water Division reported test-period commissioner fee expense of \$1,337, which reflects a 50 percent allocation of the commissioner's fees. Each of Western Lewis' 4 commissioners is paid an annual fee of \$200 for a total annual expense of \$800. A 50 percent allocation of these fees would result in a commissioner fee expense of \$400 for the Water Division, a difference of \$937 from the reported amount. Accordingly, commissioner fee expense has been decreased by \$937.

Contractual Services: The Water Division reported test-period contractual services expense of \$4,080, which includes meter reading labor of \$2,018 and accounting fees of \$1,159. In the test-period, Western Lewis allocated 50 percent of its contractual services expense to its Water Division.

Upon review of the test-period invoices Staff determined that Western Lewis paid its accountant \$1,300 for the preparation of the 1991 financial audit. This would result in an allocation of \$650⁵ to the Water Division, a difference of \$509 from the reported amount. Accordingly, contractual services expense has been decreased by \$509.

⁵ \$1,300 x 50% = \$650.

Western Lewis pays its meter reader a fee of \$500 per month or \$6,000⁶ annually. As previously mentioned, Western Lewis allocated 50 percent of its meter reading labor expense to the Water Division. In its 1990 Audit performed by the Commission's Audit Branch, this expense was allocated on the basis of the following 2 part customer ratio: (1) the number of customers with combined water and gas service; and (2) the number of customers with water or gas service alone.

Given that not all of the Water Divisions' customers have gas service, Staff is of the opinion that the customer ratio allocation better reflects the meter reading cost incurred by both divisions. Based on this method the Water Division would be allocated 71 percent or \$4,200 of the meter reading labor, as shown in Appendix D. Accordingly, contractual services expense has been increased by \$2,182.

Rents: Western Lewis reported test-period rent expense of \$4,767. Upon its review of the invoices and general ledger, Staff noted that the actual test-period rent expense was \$4,660.⁷ In the test-period the Water Division was allocated 50 percent of the rent expense, which would result in a rent expense of \$2,330, a

⁶ \$500 x 12-Months = \$6,000.

⁷

Office Rent	\$ 250 x 12-Months =	\$ 3,000
Xerox Copier	\$ 92 x 12-Months =	1,104
Microage Computer Contract		+ 556
Rent Expense		<u>\$ 4,660</u>

difference of \$2,437 from the reported amount. Accordingly, rent expense has been decreased by \$2,437.

Insurance: Western Lewis reported total utility test-period insurance expense of \$5,288, and allocated 50 percent of this amount to its Water Division. Upon review of the 1991 and 1992 invoices, Staff noted that the insurance premiums had increased to \$7,534. An adjustment based on the increased premiums would meet the rate-making criteria of "known and measurable" and therefore, Staff recommends that the increased cost be reflected in test-period operations.

A 50 percent allocation of the 1992 premiums of \$7,534 would result in a insurance expense of \$3,767. Therefore, insurance expense has been increased by \$1,123 to reflect the 1992 premiums.

Transportation: Since Western Lewis does not own a vehicle, its maintenance supervisor used his own in the test-period and was reimbursed \$550 per month or \$6,600 annually. Western Lewis did not present cost justification (i.e., business vs. personal truck usage and the basis for determining that \$550 is a reasonable cost) to support its employee truck reimbursement, nor could Staff find justification in the financial records. Absent this cost justification, Staff is unable to form an opinion as to the reasonableness of the reimbursement level, and therefore, recommends that test period operations not reflect this cost.

Miscellaneous: The Water Division reported test-period miscellaneous expense of \$1,324. Upon review of the invoices,

Staff noted that Western Lewis incurred \$272 in nonrecurring telephone costs. Since this cost will not occur in the future it should be removed from test-period operations. The Water Division was allocated 50 percent of all telephone expenses, therefore, miscellaneous expense has been reduced by \$136.

Depreciation: The Water Division reported depreciation expense of \$40,756 for the test-period. Based on its recalculation of the Water Division's depreciation expense, Staff determined that the actual depreciation expense was \$41,543, a difference of \$787 from the reported amount. Accordingly, depreciation expense has been increased by \$787.

Amortization: At the time of the field review, Western Lewis' cost to file this case and Case No. 92-331 was \$1,613. Staff is of the opinion that Western Lewis' rate case cost is reasonable.

Since utilities normally do not request a rate increase every year, the Commission's past practice has been to amortize rate case cost over a 3-year period. Staff has calculated amortization expense of \$269⁸ based on amortizing rate case cost of \$1,613 over a 3-year period and allocating 50 percent of the amortization to the Water Division. Staff recommends that \$269 of amortization expense be included in the Water Division's test-period operations.

FICA: The Water Division reported FICA expense of \$3,849. Based on the pro forma salaries and wages determined reasonable herein, the Water Division's FICA expense would be \$3,893, a

⁸ $\$1,613 \div 3\text{-Years} = \$538 \times 50\% = \$269.$

difference of \$44 from the reported amount. Accordingly FICA expense has been increased by \$44.

Operations Summary

Based on the recommendations of Staff contained in this report, the Water Division's operating statement would appear as set forth in Appendix B to this report.

C. Revenue Requirements Determination

The approach frequently used by this Commission for "non profit" water utilities is debt service coverage ("DSC"). Staff recommends the use of this approach in determining the Water Division's revenue requirement.

Staff has determined that the Water Division's annual debt service is \$39,870.⁹ The Water Division's adjusted operations reflect \$(757) in income available for debt service which results in a DSC of $(0.02)x$.¹⁰ The increase in rates requested by the Water Division would result in income available for debt service of \$80,100¹¹ and a DSC of $2.01x$.¹²

	1964 Bond Issuance	1988 Bond Series A Issuance	1988 Bond Series B Issuance	Totals
1993	\$ 22,529	\$ 9,350	\$ 7,775	\$ 39,654
1994	\$ 21,770	\$ 9,250	\$ 7,700	38,720
1995	\$ 24,461	\$ 9,150	\$ 7,625	+ 41,236
				\$ 119,610
				+ 3-Years
				<u>\$ 39,870</u>

⁹

¹⁰ $\$(757) + \$39,870 = (0.02)x$.

¹¹ $\$(898) + \$80,857 = \$80,100$.

¹² $\$80,100 + \$39,870 = 2.01x$.

Staff is of the opinion that a 1.2x DSC will provide sufficient revenues to allow the Water Division to meet its operating expenses and service its debt. A DSC of 1.2x will result in a revenue requirement of \$201,643¹³ and therefore, Staff recommends that the Water Division be granted an increase in annual revenues from rates of \$48,601.¹⁴

D. Rate Design

In its application, the Water Division filed a schedule of present and proposed rates and did not propose any changes in the rate structure. Staff is in agreement that the present rate structure should not be altered. Any increase granted in the case has been added to the existing rate structure. The rates established in Appendix A will generate the revenue requirement of \$192,142. Therefore, Staff recommends that the rates in Appendix A, attached hereto and incorporated herein, be approved for services rendered.

¹³	Debt Service	\$ 39,870
	Times: Recommended Coverage	x 1.2
	Net Operating Income	\$ 47,844
	Add: Adjusted Operating Exp.	+ 153,799
	Revenue Increase	<u>\$ 201,643</u>

¹⁴	Revenue Requirement	\$ 201,643
	Less: Normalized Operating Rev.	- 153,042
	Revenue Increase	<u>\$ 48,601</u>

E. Signatures

Mark C. Frost
Prepared By: Mark C. Frost
Public Utility Financial
Analyst, Chief
Water and Sewer Revenue
Requirements Branch
Financial Analysis Division

Brent Kirtley
Prepared By: Brent Kirtley
Public Utility Rate
Analyst Communications, Water
and Sewer Rate Design Branch
Rates & Research Division

APPENDIX A
TO STAFF REPORT CASE NO. 92-313

The Staff recommends the following rates be prescribed for customers of Western Lewis-Rectorville Water and Gas District's Water Division.

Monthly: Rates

First 1,000 gallons	\$6.70 Minimum Bill
Next 4,000 gallons	2.90 per 1,000 gallons
Next 10,000 gallons	2.00 per 1,000 gallons
Over 15,000 gallons	1.70 per 1,000 gallons

APPENDIX B
TO STAFF REPORT CASE NO. 92-313

	Actual Operations -----	Pro Forma Adjustments -----	Adjusted Operations -----
Operating Revenue:			
Residential Water Sales	\$ 143,141	\$ 400	\$ \$143,541
Unmetered Water Sales	9,501	0	9,501
	-----	-----	-----
Total Operating Revenue	\$ 152,642	\$ 400	\$ 153,042
	-----	-----	-----
Utility Operating Expenses:			
Operating Expenses:			
Salaries & Wages	\$ 44,257	\$ 6,619	\$ 50,876
Commissioner Fees	1,337	(937)	400
Utility Expense	13,003	3,868	16,871
Materials & supplies	25,959	(3,989)	21,970
Chemicals	3,291	0	3,291
Contractual Services	4,080	1,673	5,753
Rent Expense	4,767	(2,437)	2,330
Insurance Expense	2,644	1,123	3,767
Bad Debt Expense	759	0	759
Transportation Expense	0	0	0
Miscellaneous Expense	1,324	(136)	1,188
	-----	-----	-----
Total Operating Exp.	\$ 101,421	\$ 5,784	\$ 107,205
Depreciation	40,756	787	41,543
Amortization	889	269	1,158
Taxes Other Than Income	3,849	44	3,893
	-----	-----	-----
Total Utility Op. Exp.	\$ 146,915	\$ 6,884	\$ 153,799
	-----	-----	-----
Net Operating Income/(Loss)	\$ 5,727	\$ (6,484)	\$ (757)
Other Income & Deductions:			
Misc. Nonutility Expenses	727	0	727
Interest Expense	10,912	0	10,912
	-----	-----	-----
Net Income/(Loss)	\$ (5,912)	\$ (6,484)	\$ (12,396)
	=====	=====	=====

APPENDIX C
TO STAFF REPORT CASE NO. 92-331

Employees	Position	Hourly Rates	
		Regular	Overtime
Rick Hilterbrandt	Maintenance Supervisor	\$ 9.25	\$ 13.88
Rodney Hilterbrandt	Maintenance	\$ 6.00	\$ 9.00
Jean Wright	Office Manager	\$ 9.00	\$ 13.50
Glenda Vice	Office Clerk	\$ 7.50	\$ 11.25

Pro Forma

	Regular	Overtime	Salaries & Wages
Maintenance Payroll:			
Rick Hilterbrandt	2,080.00	364.50	\$ 24,299
Rodney Hilterbrandt	2,080.00	34.00	12,786
Total Maintenance Payroll			\$ 37,085
Office Payroll			
Jean Wright	2,080.00	465.50	\$ 25,004
Glenda Vice	2,080.00	161.00	17,411
Total Office Payroll			\$ 42,415
Total Pro Forma Payroll Expenses			\$ 79,500
			=====

Pro Forma Payroll Allocation:

	Pro Forma Payroll	Gas Division	Water Division
Maint. (80W/20G)	\$ 37,085	\$ 7,417	\$ 29,668
Office (50W/50G)	42,415	21,208	21,208
Pro Forma Salaries & Wages	\$ 79,500	\$ 28,625	\$ 50,876
	=====	=====	=====

APPENDIX D
TO STAFF REPORT CASE NO. 92-331

	Water Only	Gas Only	Water & Gas	Total
	-----	-----	-----	-----
Customers	409	17	533	959
	=====	=====	=====	=====

Water Allocation Factor:

Water Only Customers \ Total Bills	42.65%
(Water & Gas Customers \ Total Bills) x 50%	27.79%

Water Allocation Factor - Rounded	70.00%
	=====

Gas Allocation Factor:

Gas Only Customers \ Total Bills	1.77%
(Water & Gas Customers \ Total Bills) x 50%	27.79%

Gas Allocation Factor - Rounded	30.00%
	=====

	Water Division	Gas Division
	-----	-----
Montly Meter Reading Fee	\$ 500	\$ 500
Times: 12-Months	12	12
	-----	-----
Pro Fomra Meter Reading Fee	\$ 6,000	\$ 6,000
Times: Water Allocation Factor	70.00%	30.00%
	-----	-----
Allocated Pro Forma Meter Reading Fee	\$ 4,200	\$ 1,800
	=====	=====